TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES
Meeting Minutes for January 21, 2010, 8:30 a.m.
5th Floor West Conference Room – City Hall

Members Present: Brian Bjorndahl, Chairman
Kevin Larson, City Manager Appointee
Cindy Bezaury, Human Resources Director
Silvia Amparano, Designee for Finance Director
Gage Andrews, Employee Representative
Brandy Kadous, Employee Representative
Jean Wilkins, Retiree Representative

Staff Present: David Deibel, Board Counsel
Allan Bentkowski, Investment Manager
Michael Hermanson, Retirement & Benefits Administrator
Doris Rentschler, Lead Pension Analyst, Retirement
Claire Beaubien, Board Administrative Assistant

Guests: Jenefer Carlin, CTRA Representative
Judge Margarita Bernal, City Court Magistrate
Ron Beran, Senior Assistant Prosecuting Attorney
Pat Mehrhoff, Senior Assistant Prosecuting Attorney
M J Raciti, Principal Assistant Prosecuting Attorney

A. Call to order
Chairman Bjorndahl called the meeting to order at 8:30 a.m.

B. Consent Agenda
1. Approval of December 17th Board meeting minutes
2. Retirement ratifications for the month of January 2010
3. TSRS Comprehensive Annual Financial Report for June 30, 2009

Cindy Bezaury **moved, seconded** by Kevin Larson, to approve the Consent Agenda. **Motion passed 5 to 0** (Jean Wilkins absent at time of vote; Silvia Amparano absent at time of vote).

C. Disability Retirement Application – Glenn Hicks*

Cindy Bezaury **moved, seconded** by Gage Andrews, to approve the disability retirement for Glenn Hicks. **Motion passed 6 to 0** (Silvia Amparano absent at time of vote).

D. Investment Activity / Status Report
1. Portfolio composition, transactions and performance for December 2009

Allan Bentkowski reported that the Net Asset Value as of 12/31/2009 was $541.3 million. This compares with $536.0 million at the end of November and $548.8 million as of 1/20/2010.

As of 12/31/09, all managers remained near or within their asset allocation target ranges. With the exception of the Real Estate asset class, all asset classes remain close to their asset allocation targets. Real Estate was near the minimum of its target range at 6.2% versus 6.0% for the minimum.

For December activity, slightly more than $2 million was moved from Alliance to SteelRiver on 12/18/09 to meet a capital call. In addition, $1.5 million moved from Alliance to the Investment Pool account due to the ongoing need to meet monthly pension payment obligations.

Allan reported that $7 million will be moved out of Alliance in January to fund another capital call from SteelRiver. Also in January, the fund received slightly more than $1.5 million in distributions from JPMorgan Strategic Property account which will be transferred to the Investment Pool account at the end of that month. $2.6 million remain of the $6 million requested distribution from JPMorgan.

As for returns, 2009 closed on a positive but subdued note. Calendar year-to-date returns for the Total Fund were 15.81% versus 18.86% for the Custom Plan Index. Fixed income closed with very good returns for the year on a relative basis, returning 14.39% versus 5.93% for the Barclays Aggregate. Equities rebounded from previous lows in January and February, 2009, to post strong positive returns. Overall, four managers exceeded their benchmarks, three were relatively close to their benchmarks and two significantly lagged their benchmarks, Friess and Artio. Friess returned a 9.9% versus 37.21% for the Russell 1000 Growth Index. Artio posted returns of 23.66% versus 42.16% for the MSCI All Country Ex-US Index. However, both managers improved in the second half of the year and closed their gaps relative to their benchmarks, which will be evident in the Fiscal Year-to-Date returns.

Real Estate continues to perform poorly but, on a positive note, JPMorgan Strategic Property account finished ahead of the index at -27.51% versus -29.71% for the index. Fourth quarter ending returns show the progress the Plan made this year. First quarter returns were poor, followed by very good returns in the 2nd and 3rd quarters and then "back to normal" returns for the 4th quarter which will hopefully continue into the new year.

The first six months of the fiscal year posted fairly solid returns. Total Fund has returned 13.82% versus 14.61% for the Custom Plan Index. Bonds returned 6.51% versus 3.95% for the Barclays Aggregate. Equities returned 22.06% versus 23.99% for the Equity Composite. While continuing to lag their respective benchmarks, Friess and Artio are closing the gap between their returns and their respective benchmarks. Friess posted a 13.68% return versus 23.01% for the Russell 1000 Growth and Artio posted a return of 21.77% versus 24.31% for the MSCI All Country World, ex-US Index.

In other news, Allan reported that Ethan Hugo will assume full responsibility for the Small Cap Core product at Pyramis/Fidelity. Roger Lawson, Fidelity's president will retire at the end of March with no successor named as yet. SteelRiver completed the Pennsylvania Gas Utility Purchase that had been pending.

Gage Andrews commented that he heard that there was going to be some staff changes made in the Investment Section of the Finance Department. He asked Allan what effect these changes would have on the Pension Fund. Allan responded that his staff was being placed elsewhere within the Finance Department and the bulk of their duties would fall on him. Silvia Amparano commented that an RFP may be considered to analyze the cost/benefits of hiring an outside firm to do some of the work Allan's former staff did but it was still in the analysis stage. Allan commented that if an RFP was issued, it would be for the management of City funds and would not involve TSRS. He would still be running the pension fund in-house fixed income investments and oversight of the other pension accounts as well as running the City side for an undetermined amount of time, possibly forever. He reiterated that the staff changes should have a minimal effect on the Pension Fund, although this would depend on how much help he gets on the City side.

E. Timber Investment (Educational) Presentation – Tim Cayen, Hancock Timber Resource Group

Allan introduced Tim Cayen from Hancock Timber Resource Group who gave a presentation on Timber Investment. Tim began his presentation with the fact that the vast majority of timberland used in the Timber Asset class is located in North America – Canada and the U.S. There is also a large market in Australasia, Australia and New Zealand. A developing market is in South America, specifically Brazil. Within the next 5 – 7 years Brazil is projected to be a net importer of timber. Most of the Brazilian timber is the Rain Forest and it is illegal to harvest that timber.

Tim gave the Board a short lesson on how timber is grown, planted and harvested. In 2009, the planting of 65 million seedlings was completed which actually took two years to accomplish since it is all done by hand. Many trees are planted close together to encourage straight growth as they grow towards the sun.

Tim commented that one of the things his company does is manage forest sustainably. They manage over 4.5 millions acres of timberland with the goal of maximizing returns for our investors while benefiting local communities and the environment. Hancock believes that in-house forest management significantly reduces costs for investors. It also aligns the interests of investors and property managers and delivers value-enhancing forest management.

Hancock Timber Resource Group was founded in 1985 and is the world's largest manager of timberland investments for private equity investors. This firm develops and manages globally diversified timberland portfolios for investors including pension funds, insurance companies, taxable corporations, foundations, endowments and family offices. While timberland's historically strong returns have included a meaningful cash component, timberland investments have also proven to be of relative low risk – as measured by volatility and correlation with the returns from other financial assets. And, in contrast to most financial assets, timberland has also been a good hedge against inflation, especially against unanticipated inflation.

Timberland has proven to have the highest positive correlation with inflation, next being private commercial real estate. Following unprecedented events in financial markets over the recent past and the monetary policy responses as a reaction around the globe, a wide variation exists among investors on the expectations for price inflation going forward. All else equal, Tim commented, one would agree that investors prefer a portfolio with returns that are insensitive to departures from inflation expectations, whatever their expectations may be.

In summary, expected returns for timberland global timberland properties have compressed modestly in recent years, but are expected to increase slightly over the next 2 – 3 years. In general, timberland investments outside the United States are riskier, but offer compensatory increases in expected return. Timberland returns in different regions are imperfectly correlated, so a global portfolio can deliver target returns at lower risk.

Allan asked Tim if the funds were easily liquidated once they were committed. Tim replied that the funds were in co-mingled funds and would be difficult to liquidate any portion.

F. Administrative discussions

1. Discussion of End of Service Program Sunset

Mike Hermanson stated that the End of Service Program was created in the Spring, 2006 and was designed to sunset at 12/31/2010. The sunset was intentional, because the board wanted to have a period of time to determine the pro's and con's of running a program that the system had no prior experience with. Eligible members have until December, 2010 to sign up to participate in the End of Service Program and could then work up to 12 months, retiring no later than 12/31/2011. Mike commented that if the Board has an thoughts toward resurrecting the End of Service program after the sunset, this information should be communicated to the members as soon as possible, to avoid any false impressions that the program is ending when it is known that it will be reinstated. This is important because of the associated affect this program has had on member behavior; where some members have purchased just enough service credits to become eligible to enter the End of Service program by 12/31/2010 and because entering the End of Service program enables employees to qualify for the City's 75/25 subsidy program for retiree's insurance premiums which is also changing after this year.

The City Manager has asked the Board to consider accelerating the End of Service sunset provision to a June 30th, 2010 date, and shorten the participation period to 6 months, so that the program would completely end at December 31, 2010, rather than the 12 months allowed. Mike said that accelerating the sunset date by six months would upset a lot of employees' plans made to enter the program at the end of December, and further complicate participation for those already enrolled in the program. Jean Wilkins asked if the June date was proposed to cause more people to leave the system sooner than previously expected. Cindy Bezaury responded to Jean's question that layoffs have been the sole topic of conversation amongst the City Manager and staff, along with Council members and staff. It was suggested that accelerating the End of Service sunset date might encourage people out sooner, thereby vacating positions that would otherwise have to be vacated by layoffs. It is not certain that accelerating the End of Service sunset would save any money. Jean commented that the Board has made a commitment to sunset the program on 12/31/10. Cindy replied that no direction is being made for the Board to take action, just an issue put forth by the City Manager's staff and it is her duty to bring it to the Board for consideration.

Mike commented that there are three issues being discussed: 1) will the sunset date stay as previously published?; 2) will the End of Service program continue without a sunset date and/or could there be a hiatus between the sunset date and a new End of Service program?; and 3) can the sunset date be accelerated six months to 6/30/10? Jean commented that the hiatus would not be fair to some employees who would not be able to take advantage of the program. Mike said that he was raising the question whether or not to have a hiatus and, if so, for how long. Gage asked if employees are notified that they will be laid off, do they have the opportunity at that point to accelerate and enter the End of Service and retire rather than being laid off. Doris Rentschler responded that there is currently someone in the End of Service program who was notified that she will be laid off. She chose to retire rather than go through the layoff process. While this greatly reduced the amount of time she was in the End of Service, it prevented her from being laid off. It should be stated, there is no protection from layoff by participating in the End of Service. Gage asked if the sunset date was accelerated, would the medical deadline to receive the 75/25/ split be also accelerated. Mike responded that the medical subsidy issue is independent of anything decided by this Board, since that is a City benefits program, but the intent is to keep the 12/31/10 deadline.

Gage asked if more people would join the End of Service program because of the potential of layoff. Doris commented that the people who are targeted for layoffs are typically people who have no bumping rights and are not eligible to retire. It was atypical to have someone in the End of Service program laid off but that was only because the division had been eliminated or the position had been eliminated. Chairman Bjorndahl commented that he had a difficult time considering changing anything about the End of Service program that would be detrimental to the members. As a fiduciary, it is his responsibility to ensure the soundness of the System and to protect the interests of its members and it doesn't appear that the members will realize anything positive from accelerating the sunset date.

Jean Wilkins **moved, seconded** by Gage Andrews, to continue the End of Service program as written, without accelerating or changing the sunset date of the program. Cindy commented that she is setting aside her position as member of the City's leadership team and will be voting yes on this motion because it is in the best interest of the members. Silvia Amparano commented that she will also be voting yes on this motion because she doesn't see any good coming to the system short term and she thinks it would be too confusing for everyone concerned. **Motion passed 7 – 0.**

2. Disability Income Verification Audits

Mike recounted that back in November, the Board agreed to modify the income limit for disability retirees to 50% of their adjustment income. During the discussion of this change, staff had asked for time to study and review the effect of assigning a limit on all income receipts from employer-sponsored income benefits received by disabled retirees (e.g. Social Security, Worker's Comp., TSRS, LTD). Based on the analysis, it remains difficult to determine what an appropriate upper limit should be. For example, using 100% of the adjusted income caused only one person (out of 28 used in this study) to exceed the limit, resulting in very isolated application. Also, there are complications with certain types of income; such as Long Term Disability income, is offset against TSRS and Social Security received. Another consideration is that ½ of Social Security payments are funded by employee contributions, so it has participation that complicates what might be thought of as an employer provided benefit. Cindy remarked that as an employer, her only concern is that people make more money as a result of a lifetime benefit from worker's compensation. In Arizona, Worker's Compensation is a lifetime benefit. She has concerns about a retiree who collects a TSRS disability benefit, an LTD benefit, a Social Security Disability Benefit and a lifetime benefit from a worker's comp claim which is 100% funded by the employer, and the employee is working.

She would recommend that future audits focus primarily on disability retirees who are receiving worker's compensation and/or earned income. Conversely, if they are collecting Social Security, LTD and/or TSRS, a threshold of 100% of adjusted income is unnecessary. Doris recounted, to clarify:

If a retiree has received earned income and/or workers compensation payments, and the sum of their total income exceeds 100% of adjusted base pay, then the TSRS benefit would be reduced so that total income does not exceed the 100% threshold; up to the full TSRS benefit received on an annual basis (no carryovers). If a person exceeds the 100% adjusted income but does not have worker's comp and/or earned income, no adjustment needs to be applied. Mike advised the Board that an ordinance will need to be written and brought back for Board approval so that it can be added to a future agenda for Mayor & Council approval.

3. Impact of Budget Changes

Recent budget changes announced by the City Manager indicated that a $100,000 charge to the TSRS budget will occur as part of the City's effort to balance the budget for work done by other departments for TSRS. This would normally cause a change request to the TSRS budget, but due to the fluxing going on, the issue will be reviewed and Mike will bring this item back on a future agenda. The point of this brief discussion today is to raise the Board's awareness to the matter. In prior years, the TSRS budget had received direct billings for services, but the policy changed this year where this was not occurring, but now the prior policy is returning. Associated with reviewing future budget impacts, is the issue of the City physician's fees charged to Risk Management for medical evaluation for disability retiree applicants will be charged to TSRS for FY11. Jean remarked that is only appropriate since it is an evaluation to determine if a person is totally and permanently disabled in accordance with our rules and regulations.

Cindy brought up a related issue to the budget regarding pension contribution amounts that are affected by service credits given to employees for furlough time. Current code allows up to 40 hours of furlough time for FY10. Mike remarked that it was changed to 40 hours to accommodate city magistrates following what was originally included in the revised code, Sec. 22-36(b)(4), which allowed up to 96 hours credit for furlough hours. Since this ordinance was restricted to FY 2010 only, it will need to be revisited for FY 2011, probably around the March meeting.

4. Arizona retirement systems information exchange, February 18, 2010

Mike reminded the Board that Arizona State Retirement System is hosting an information exchange on February 18, 2010. He is going to attend, along with Doris, Jean, Cindy and Allan. If anyone else would like to attend, please let Claire know well in advance of the meeting. Although ASRS asked for a list of attendees no later than 1/29/10, Mike was sure they would welcome any and all who want to travel to Phoenix.

G. Election Committee Report

Brandy Kadous reported that a total of 209 valid votes were cast for Gage Andrews, making him duly re-elected to the seat that expired 1/20/2010. Dave Deibel reported that a proposed amendment will be brought to the Board for review regarding the election rules requiring mailing ballots to members when there is only one candidate.

H. Pension Articles for the Board's Information, Education

1. GFOA Draft Recommended Practice - Governance of Public Employee Retirement Systems

This article is partly in response to recent publications regarding activities of ex-Board members. Some pension plans have paid former Board members significant amounts money as part of the compensation arrangement made with money managers that have been hired, as a result of a recommendation made by the former Board member. A Code of Ethics list is included in the article for the Board's information. This article is definitely worthwhile reading for all Board members.

2. Governing January 7, 2010 Article: 2010 Retirement Reform Resolutions

Many pension plans are reviewing the elements of their plans to see if they are in order considering the current financial environment. Arizona State Retirement System has recently proposed an amendment to the state legislature asking for revisions to eligibility from 80 to 85 points and to change their pension calculations from high 3 year average to a highest 5 year average in a 10 year period. Mike suggested that things like this are starting to happen, to mitigate funding ratios, and the Board may want to be thinking about plan design elements at some point in the future.

3. Governing January 7, 2010 Article: 2010 Pension Investment Outlook
Most noteworthy in this article, was the Federal tax on securities trades, which could be detrimental to investment returns. This is an item to watch for in the coming months.

I. Future Agenda Items
Disability Income Verification Audits - ordinance
Furloughs – amend ordinance & FY11 discussion
Hewitt – Investment Review –February
JPMorgan, Causeway – Manager Reviews – February
Budget – March
Real Estate Investment Policy Regarding Cash Withdrawals - February
Ballots Revision – April
Pyramis, TCW, BlackRock – Manager Reviews – May

J. Call to audience
Jenefer Carlin asked hypothetically, if an investment were considered in Timber, where would the funds come from? Allan replied that funds would probably be reallocated to Timberland in accordance with a structured change in the TSRS investment policy, just as it was done when the fund invested in Infrastructure.

K. Adjournment

Gage Andrews **moved, seconded** by Tameron Collins, to adjourn the meeting. **Motion passed 6 to 0,** (Kevin Larson, absent at time of vote). Meeting adjourned at 9:03 a.m.

Approved:

Brian Bjorndahl, Chair Date 2-25-10

Michael Hermanson, System Administrator Date 02-25-10